No. 22,751

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

DON R. THOMPSON AND MILDRED THOMPSON,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE

TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONERS

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INDEX

CITATIONS

Cases:

Page

Statutes:

Miscellaneous:

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OPINION BELOW

The opinion of the Tax Court (R. 93) is reported at 49 T.C. No. 24.

JURISDICTION

Petitioners are individuals and at all relevant times resided at 334 Calle de la Azucena, Tucson, Arizona.

This petition is filed pursuant to the provisions of Sections 7482(a), 7482(b), and 7483 of the Internal Revenue Code and involve income tax for the year 1963.

The respondent is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States.

A notice of deficiency was mailed to petitioners on December 8, 1965. On January 13, 1966, petitioners paid the amounts of the proposed deficiency plus interest thereon (in the amount of $4,350.43 of deficiency for the year 1963 plus interest of $456.80, and $1,910.19 of deficiency for the year 1964 plus interest of $85.96, a total of $6,803.38). On February 28, 1966, within the time permitted by Section 6213 of the Internal Revenue Code, petitioners filed a petition for redetermination with the Tax Court. Issue was joined by the filing of respondent's answer on April 22, 1966. The case was tried in Phoenix, Arizona on February 13, 1967 before the Honorable C. Rogers Arundell. On December 15, 1967, the Tax Court filed its opinion directing that a decision be entered under the Tax Court's Rule 50. The opinion by Judge Arundell was not reviewed by the Tax Court. On February 5, 1968, the Tax Court entered its decision ordering and deciding that there were overpayments of federal income taxes for the years and in the amounts previously set forth but that the petitioners were not entitled to the investment credit they had claimed for 1963. The case was brought to this Court by a petition for review filed April 5, 1968, within the three month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of that Code.

QUESTION PRESENTED

The sole question for decision is whether the petitioners are to be denied an investment credit on certain property which they purchased in 1963 solely because they had at a prior time owned the property.

STATUTES AND REGULATIONS INVOLVED

The applicable provisions of the statutes, regulations, and Congressional Committee Reports are set forth in the Appendix, infra.

STATEMENT

The basic facts in this case are not in dispute. They were stipulated or admitted in the pleadings.

On December 4, 1957, petitioners entered into a lease agreement with the owners of certain premises located in Tucson, Arizona. Shortly thereafter, petitioners commenced the conduct on these leased premises of a business known as Redwood Lodge, a restaurant. On April 2, 1962, petitioners sold the business, including all the personal property used in connection therewith, to Redwood Gay Nineties Lodge, a corporation. To secure part of the purchase price, a note and chattel mortgage were taken. (R. 22.)

The purchasers failed to make the payments on the said note and mortgage, and the mortgage was foreclosed and the property purchased by petitioners on April 4, 1963. The corporation, Redwood Gay Nineties Lodge, and its stockholders, were not related to petitioners within the meaning of either Section 267 or 707(b) of the Internal Revenue Code of 1954. (R. 22.) The property so purchased by peti-

tioners on April 4, 1963, included $46,371.71 of tangible personal property with a useful life of seven years. (R. 23, R. 93, R. 95, Exhibit B of Joint Exhibit 3-C.)

Petitioners had a gain on the purchase of the property. This gain, amounting to $19,593.49, consisted of the amount by which the fair market value of the property purchased exceeded the income tax basis of the note that was used to pay for the property. (Explanation A, R. 6; R. 93.)

The acquisition by petitioners on April 4, 1963 of the property referred to was a purchase of the property within the meaning of Section 179(d)(2), IRC, and the property was thereafter used by the petitioners and not by the corporation which had previously been using it. The property was, however, the property which had been owned and used by petitioners for over four years prior to their sale of the property on April 2, 1962. (R. 93-4.)

Inasmuch as the acquisition of the property qualified as a purchase within the meaning of Section 48(c)(1) [which incorporates the definition of 179(d)(2)], petitioners claimed an investment credit in connection with the acquisition of such property. Upon audit of petitioners' income tax return for 1963, this investment credit was disallowed by respondent on the basis that the property did not qualify as "used section 38 property" because of the statutory provision that "property shall not be treated as 'used section 38 property' if, after its acquisition by the taxpayer, it is used by a person who used such property before such acquisition . . ."

Before the Tax Court, petitioners contended that the statutory language regarding use of the property prior to acquisition was ambiguous and that the Court should look to the legislative purpose of the enactment. Petitioners further contended that when that legislative purpose was examined, it would be clear that Congress had in mind situations where the property was being used immediately before its acquisition by the same person who used such property immediately after its acquisition and that the quoted provision of Section 48(c)(1) was enacted "to prevent abuse."

Respondent contended that the statutory language was not ambiguous, and therefore the Court should disallow the investment credit because of the clear dictate of the statute.

At the trial, the attorney for respondent admitted, in response to a question from the presiding judge, that petitioner "should have available to him the investment credit that he would have as a purchaser, and it was not the intent of Congress to deny him the investment credit in such a circumstance as this." (Transcript 7, lines 11-23.)

The Tax Court appears to have agreed with petitioner that the language of the statute is ambiguous, for it is stated in the Opinion, "at the outset, it should be noted that our only problem here is to determine the intent of Congress in enacting the second sentence of Section 48(c)(1) . . ." (R. 98.) If the statutory language were clear and unambiguous, there would be no need to resort to a determination of the intent of Congress.

The Tax Court disagreed with petitioners' suggested rewording of the statute to reflect the Congressional intent. (R. 99.) The Court explained that, "In the first place, it (the statutory provision) only applied to property acquired by purchase after December 31, 1961. Petitioners first acquired this property in or about 1957." (Lines 1-3, R. 101.) The Court concluded that, "We express no opinion on facts different from those presented in the instant case." (R. 101.)

SPECIFICATION OF ERRORS RELIED UPON

The Tax Court erred in:

1. After impliedly concluding that the statutory language was ambiguous, and that resort should be had to the Congressional history, failing to give adequate weight to the Congressional reasoning for inserting the subject provision in Section 48(c)(1) and therefore failing to interpret the statute to carry out the Congressional purpose.

2. Failing to give any weight to the admission by respondent at trial that if the statute was ambiguous, then the intent of Congress was not to deny petitioners an investment credit in such a circumstance as this.

3. Determining, contrary to the statute, the stipulations and the positions of both parties, that a purchase within the meaning of Section 48 had not taken place in 1963.

4. Entering a decision for respondent in accordance with its erroneous interpretation of the Congressional intent, the law, and the positions of the parties in connection with the question of prior us

SUMMARY OF ARGUMENT

<u>Section 48(c)(3)</u>, IRC, provides that the term "purchase" shall have the meaning assigned by <u>Section 179(d)(2)</u>. The transaction whereby petitioners acquired the subject property in 1963 qualified as a purchase as that term is defined in the statute.

Since the statutory language dealing with prior use is susceptible of more than one interpretation, resort must be had to the Congressional intent in enacting the provision. An examination of the examples set forth in the committee report accompanying the bill shows that each of the situations there described had two characteristics:

1. The identity of the person using the property was the same before the change of ownership as after it; and

2. The transaction in which ownership changed was one in which there would normally be no investment credit recaptured.

Since the purpose of the provision was "to prevent abuse," it would appear that the abuse Congress had in mind was one in which no change really took place in the identity of the person using the property <u>and</u> in which the tax collector would not be entitled to recapture the investment credit previously taken by the "seller."

Neither condition is present in the instant case. Petitioners had not been using the property before their repossession of it, although they had used the property previously. The corporation which "sold" the property to petitioners would have been entitled to an investment credit upon its acquisition of the property, and would have been subject to an investment credit recapture as a result of the same transaction in which

petitioners claim they are entitled to an investment credit. This is in sharp contrast to the examples in the Committee Report where the sellers would not be subject to an investment credit recapture. It is obviously inequitable to allow an investment credit to a buyer when the seller has previously been allowed an investment credit on its purchase of the same property if that investment credit is not subject to recapture. Absent the recapture, the investment credit is being allowed twice on the same property, and petitioner contends that this was the "abuse" to which Congress directed its prohibition. If the investment credit of the seller is recaptured, though, then it is equitable that an investment credit be allowed the buyer.

ARGUMENT

I

THE TERM "PURCHASE" IS SPECIFICALLY DEFINED IN THE STATUTE, AND PETITIONERS' ACQUISITION IN 1963 QUALIFIED AS A PURCHASE UNDER THAT DEFINITION.

Section 48(c)(3) provides that "The term 'purchase' has the meaning assigned to such term by Section 179(d)(2)."

Section 179(d)(2) states that a purchase is any acquisition of property if certain conditions do not exist. These conditions (see Appendix) relate to the relationship between the person acquiring the property and the person from whom acquired. Such relationships do not exist in this case. In addition, a purchase would not exist if the tax basis of the property in the hands of the persons acquiring it was determined in some fashion by reference to the tax basis of the property in the hands of the person from whom acquired. Petitioners

do not derive their tax basis from the persons from whom they acquired the property. The stipulated facts make it quite clear that this transaction qualifies as a purchase within the meaning of the statute, and respondent has never contended otherwise.

Even the summary of the case prepared by the Tax Court describes the transaction involved as a purchase. Therefore, to the extent that the Tax Court held that the acquisition involved was not a purchase, such a finding was contrary to the stipulated facts, the positions of the parties, and the statute. Since such a determination is pivotal as to whether petitioner is eligible for an investment credit, it is submitted that the decision should be reversed as a result of this clearly erroneous finding.

ARGUMENT
II

THE STATUTORY LANGUAGE IS AMBIGUOUS AS TO TIME OF DISQUALIFYING USE, AND THEREFORE RESORT MUST BE HAD TO THE CONGRESSIONAL HISTORY OF THE STATUTE IN ORDER TO PROPERLY DETERMINE ITS INTENDED MEANING.

While the Court below never specifically reached a determination as to whether the statute was or was not ambiguous, its comment that "Our only problem here is to determine the intent of Congress in enacting the second sentence of Section 48(c)(1), <u>supra</u>" (R. 98) is a tacit admission that the statute is ambiguous. Otherwise, no resort to an attempt to determine the Congressional intent would be necessary, but respondent's contention that the literal language of the statute bars the credit claimed would have carried the day without any further

discussion. "Where the language is plain and admits of no more than one meaning the duty of interpretation does not arise and the rules which are to aid doubtful meaning need no discussion." Caminetti v. U. S., 242 U. S. 470, 61 L. Ed. 442, 37 Sup. Ct. 192.

The statutory language used is clearly ambiguous relative to the time of disqualifying use. The determination of whether a taxpayer is entitled to an investment credit is made at the time of acquisition, so the phrase, "if, after its acquisition by the taxpayer," must imply immediately after its acquisition," since otherwise the provision would require clairvoyant powers to administer. But if the word "immediately" is to be implied as a modifier to "after its acquisition," it seems consistent that it might be implied as a modifier to "before such acquisition" as well. Further, the article "a" in the phrase "a person who used such property before such acquisition" could mean "any one who ever used such property at any time before such acquisition," as respond contends it unambiguously does, or it could mean "the person, or any one of the persons where more than one user is involved, who were using such property before its acquisition . . ." Petitioner contends that the language used is susceptible of either interpretation.

Petitioner therefore contends that the language of the statute is not so clear and precise, free from ambiguity, and subject to only or possible interpretation that resort to interpretation is barred, but rather contends that, as the Tax Court said, "Our . . . problem here is to determine the intent of Congress in enacting the second sentence of Section 48(c)(1), supra."

ARGUMENT
III

THE PROVISION AS TO PRIOR USE WAS ENACTED "TO PREVENT ABUSE." WHAT WAS THE ABUSE SOUGHT TO BE PREVENTED? IT WAS THE OBTAINING OF AN INVESTMENT CREDIT IN A SITUATION WHERE THE IDENTITY OF THE PERSON USING THE PROPERTY WOULD NOT BE CHANGED AND THE SELLER OF THE PROPERTY WOULD NOT BE SUBJECT TO AN INVESTMENT CREDIT RECAPTURE.

Change in User

Section 38, IRC, allows a credit which may be offset directly against income tax liability. The credit is an amount equal to seven per cent of "qualified investment" in both new equipment and in up to \$50,000 per year of used equipment. The equipment involved must have a useful life of at least four years, and the percentage of the cost of the equipment which may be counted as "qualified investment" depends upon the useful life of the equipment when acquired. Sections 46 and 48 spell out these rules.

Section 47 provides that if a taxpayer disposes of equipment on which he obtained an investment credit before having used that equipment for the useful life on the basis of which he obtained the investment credit, he must repay to the government the "unearned" portion of the investment credit. This is the "investment credit recapture" provision.

In the case of new property, the investment credit presented no opportunities for abuse by taxpayers. But used property involved a complication. A taxpayer using property could arrange a transaction whereby the property was ostensibly sold, although the same user con-

tinued to use it, and thereby create an investment credit for used property in a situation where Congress had not intended an investment credit to be allowed (i.e., in a situation where there was no actual change taking place in the identity of the person using the property).

Thus, we find in the Senate Finance Committee Report on the bill:

". . . Used property [Section 48(c)], eligible for the credit, . . . of course, is not property which is new in use with the taxpayer. To prevent abuse, however, there has been omitted from the term 'used property,' available for the credit, that which is used by a person who used the property before such acquisition . . ." Senate Report No. 1881, 87th Congress, 2d Session, p. 15 (1962).

The specific language that Congress used to implement that intent reads, as we have noted, "Property shall not be treated as 'used section 38 property' if, after its acquisition by the taxpayer, it is used by a person who used such property before such acquisition . . ." [IRC 48(c)].

We have seen that the stated purpose of this particular language was "to prevent abuse" of the allowance of an investment credit for used equipment. What abuse? The Senate Finance Committee Report illustrated the abuse that the Committee had in mind by giving several examples (emphasis supplied):

"Thus, if property were sold under a sale and leaseback arrangement, such property in the hands of the purchaser-lessor would not be used section 38 property since the property, after its acquisition,

is being used by the same person who used it before the acquisition. Similarly, where a taxpayer has been leasing property, and subsequently purchases such property (whether or not the lease contained a purchase option feature), such property is not used section 38 property with respect to such taxpayer, since it is being used by the person who used such property before its acquisition. In addition, if property owned by a lessor is sold subject to a lease or is sold upon the termination of a lease, the property will not qualify as used section 38 property with respect to the purchaser, if thereafter the property is used by a lessee who used the property before the acquisition." Senate Report No. 1881, supra, p. 158.

All of these examples deal with situations where there is no change taking place in the person who is using the property. In the sale and leaseback, the legal title to the property is being transferred, but the former owner continues to use the property without interruption. If a lessee purchases property which he has been leasing, there is no interruption in his use of the property. If property is sold subject to a lease, the lessee continues to use the property without interruption.

What, then, is the abuse to which Congress directed this provision? From the examples given, it seems clear that Congress was concerned that an investment credit might be obtained when, in fact, there was no change in the identity of the person using the property.

Congress could have said, "Property shall not be treated as 'used section 38 property' if, after its acquisition by the taxpayer,

it is used by the person who used such property before such acquisition . . ." In such an event, petitioners' position would be clearly correct In fact, the Committee used this language in two of its examples. However, this would not have fully solved the problem of insuring that there was a real change taking place in the identity of the person using the property, for there are types of property that are used by more than one person. For example, a truck may be leased to X for use one day of the week and to Y for five days of the week; or a computer may be leased to X, Y and Z on a time-sharing basis. (For an example of multiple compute use, see Allis Chalmers Mfg. Co. v. U. S., (DC-Wisc. 1961) 8 AFTR 2d 5668, 200 F. Supp. 91, in which a computer was being used by six industrial and public utility corporations.) Use of "the person" instead of "a person" would not have covered the purchase of the truck by Y or of the computer by Z. That the Congress was aware of multiple user problem seems apparent (p. 158, supra) from the Committee Report comment that property could be treated as used section 38 property even though the purchaser had "also made some casual use of it before acquisition."

Relationship to Investment Credit Recapture

It is also important to note that the three examples given by the Committee (sale and leaseback, purchase of property by lessee, sale of leased property subject to the lease) all have another characteristic in common. None of these transactions results in an investment credit recapture.

Regs. 1.47-3(g) states that "Notwithstanding the provisions of Section 1.47-2, relating to disposition and cessation, paragraph (a) of

Section 1.47-1 shall not apply where Section 38 property is disposed of and as part of the same transaction is leased back to the vendor even though gain or loss is recognized to the vendor/lessee and the property ceases to be subject to depreciation in his hands." Similarly, Regs. 1.47-2(b) provides that, where a lessee has received an investment credit, the disposition of the property by the lessor shall not trigger recapture of the investment credit that was involved in connection with the property.

This we should contrast with the basic situation faced in the instant case, bearing in mind that the decision of this Court as to the meaning of this statute is going to apply to not just this taxpayer but to other taxpayers who use property, sell it in a bona fide transaction but receiving a chattel mortgage back, and ultimately have to foreclose on that chattel mortgage. As pointed out by respondent at trial (Transcript 9), the implication of the Government's position is that any prior use, other than casual use, disqualifies from the investment credit. The property may have originally been acquired on any date, sold, and then reacquired five, ten or any number of years later. Any prior use permanently "taints" the property!

Assume in the three situations below that equipment (new or used) with a thirteen year life is purchased by A for $50,000, held for three years, and then sold to B for $40,000. In turn, B uses the equipment for three years and it is then repurchased (repossessed or foreclosed) by A when its value is $30,000. The three situations are:

1. The examples in the Congressional Committee Reports.

2. The rule propounded by the Tax Court.

3. The rule argued for by petitioners.

	Committee Examples	Tax Court Rule	Petitioners Contention
1. Investment credit when A purchases	$ 3,500	$ 3,500	$ 3,500
2. Recapture when A sells to B	0	(3,500)	(3,500)
3. Investment credit to B on purchase	0	2,800	2,800
4. Recapture from B when A reacquires	0	(2,800)	(2,800)
5. Investment credit to A on repurchase	0	0	2,100
Net Investment Credit	$ 3,500	$ 0	$ 2,100

Granting an investment credit in step 5 above would be a dupli cation in the situations covered by the Committee's examples, since ther has been no recapture. Failure to grant the investment credit in step 5 under the Tax Court rule means that no net investment credit is granted to anyone. Allowing an investment credit in step 5 above, as per petitioners' contention, produces a result comparable to the Committee Report examples.

It is stated in Mertens Law of Federal Income Taxation, Vol. 1, ¶3.13, p. 23, "The purpose of construction is to harmonize the law and save ambiguous statutes from ineffectiveness. The legislative intent is to be drawn from the whole statute, so that a consistent interpretation may be reached and no part shall perish or be allowed to defeat another. No provision of a statute stands alone, but each must be read

with the others bearing upon it. A construction of a revenue statute conforming to the purpose of the statute and to the purpose of the Congressional enactment as an organic whole is preferred over a construction thwarting and distorting that purpose." (Citations omitted.)

The interpretation contended for by respondent appears to clearly frustrate the purpose of not only this legislation but of other tax law provisions. If the seller of property must repay the investment credit he previously took when he sells that property, but cannot obtain an investment credit if he must repurchase the property which he sold, this is bound to act as a deterrent to making sales for other than cash. This becomes difficult to impute to Congress when we consider that in Section 453, IRC, the Congress has provided for over 40 years a provision which has as its avowed purpose the encouragement of installment sales of property by allowing the sellers to report their gain on sale only as they collect the sales proceeds. When it appeared to the Congress in 1964 that taxation of sellers of real property upon repossession of such real property was imposing an undue burden on such transactions, the Congress enacted Section 1038, IRC (P. L. 88-570, September 2, 1964) to provide that such repossessions did not produce gain to the seller.

This Court itself has rejected attempts to deprive taxpayers of the benefit of the installment sale provisions as "punishment" for having failed to correctly report an installment sale transaction, commenting, "No forfeiture or penalty is assessed by law for such a mistake . . . We find the Tax Court in error in its imposition of a penalty on

taxpayer . . ." The penalty involved was refusal of the right to take advantage of Section 453. Peter Mamula v. Commissioner, 15 AFTR 2d 1269, 1272; 346 F. 2d 1016.

In spite of this, are we to infer unto Congress an intent, nowhere expressed in the statute or committee reports, to impose a penalty on those persons making installment sales of business equipment who subsequently have to repossess that equipment? Did Congress intend that sellers, faced with an investment credit recapture on the sale of equipment, should hesitate to make deferred payment sales because they would not be entitled to an investment credit (to offset in part that which had been recaptured) in the event that the property would have to be taken back?

It is hard to imagine that a Congress which was trying to encourage small business (the provision allowing an investment credit on used equipment being mainly for their benefit, as was the provision allowing the investment credit to offset tax liability 100 per cent for up to $25,000 of tax, but only 25 per cent on tax above $25,000) and was concerned about the poor, the underprivileged, the minority groups, having such an intent. It is these groups who would be most affected by any disinclination of sellers of business equipment to make deferred payment sales.

It certainly cannot be construed as the intent of Congress that taxpayers should be permanently deprived of any investment credit at all simply because a bona fide sale of property is succeeded by a bona fide repossession of the property sold. Yet this is exactly what

respondent would have the Court believe that Congress intended to inflict upon the small businessmen of the United States.

Example

In 1963, Taxpayer X purchases new equipment to use in his business at a cost of $70,000, and with a useful life of 8 years. On his 1963 income tax return, he takes an investment credit of $4,900. In 1966, he sells this equipment to Y for $50,000. On his 1966 tax return, X must report as an addition to his tax the $4,900 of investment credit which he took in 1963 (IRC 47).

However, when X sold the equipment to Y, he took back a chattel mortgage to secure the unpaid balance of the selling price. In 1968, X forecloses on his chattel mortgage and reacquires the equipment. The balance on the mortgage at that time is $25,000, which is also the value of the equipment. X will be considered as having purchased the equipment at a cost to him of $25,000. If the equipment at that time has a useful life of four years, X would be entitled to an investment credit of one-third of 7 per cent of $25,000, or $583, other than for respondent's interpretation of the law.

X certainly is entitled to some investment credit sometime, in all fairness and logic. He has engaged in exactly those kinds of transactions which the investment credit was designed to stimulate. He has not, in any manner, abused the investment credit. While the law provides no mechanism to restore to him the $4,900 investment credit which he had to pay back in 1966, certainly he should not be also penalized by being deprived of the $583 of investment credit in 1968 unless it is quite clear that Congress intended such deprivation.

Summary

The Congressional Committee Report illustrates the types of situations which were in the minds of Congress when this piece of legislation was enacted. These are situations where (1) the title to

the property changes, but the property continues to be used by the same person(s), and (2) the "disposition" of the property in the transaction involved does not normally result in a recapture of the investment credi Allowing an investment credit under such circumstances would be a double abuse of the investment credit provision, since not only would the investment credit be twice allowed on the same equipment but also the economy would not be aided at all by such a transaction. The economy is aided by having the assets of a dormant business purchased, and the business revitalized and employment given to persons otherwise unemploye and this is exactly what happened in the instant situation.

In the instant situation, Redwood Gay Nineties Lodge, a corporation, would have had an investment credit recapture in 1963 when petitioners purchased the subject property from them. Redwood Gay Nineties had been using the property for a year prior to its purchase by petitioners, and petitioners took over the property and commenced operating it only after they purchased it from Redwood Gay Nineties. Thus, there would be no double allowance of the investment credit if petitioners are allowed an investment credit.

Each example used by the Senate Committee Report is a situation where the person using the property immediately after the transaction was also using the property immediately before the transaction, and is a situation where the transaction would not normally result in investment credit recapture. *Expressio unius est exclusio alterius.*

CONCLUSION

For the reasons stated above, the decision of the Tax Court is erroneous and should be reversed.

Respectfully submitted,

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June ____, 1968

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

June ____, 1968

Don R. Thompson, Petitioner

APPENDIX

Internal Revenue Code of 1954:

SEC. 38. INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY.

(a) General Rule.—There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under subpart B of this part.

(b) Regulations.—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this section and subpart B.

SEC. 47. CERTAIN DISPOSITIONS, ETC., OF SECTION 38 PROPERTY.

(a) General Rule.—Under regulations prescribed by the Secretary or his delegate—

(1) Early disposition, etc.—If during any taxable year any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the useful life which was taken into account in computing the credit under section 38, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from substituting, in determining qualified investment, for such useful life the period beginning with the time such property was placed in service by the taxpayer and ending with the time such property ceased to be section 38 property.

(2) Property becomes public utility property.—If during any taxable year any property taken into account in determining qualified investment becomes public utility property (within the meaning of section 46(c) (3) (B)), then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from treating the property, for purposes of determining qualified investment, as public utility property (after giving due regard to the period before such change in use). If the application of this paragraph to any property is followed by the application of paragraph (1) to such property, proper adjustment shall be made in applying paragraph (1).

(3) Carrybacks and carryovers adjusted.—In the case of any cessation described in paragraph (1) or any change in use described in paragraph (2), the carrybacks and carryovers under section 46(b) shall be adjusted by reason of such cessation (or change in use).

(4) Property destroyed by casualty, etc.—No increase shall be made under paragraph (1) and no adjustment shall be made under paragraph (3) in any case in which—

(A) any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, on account of its destruction or damage by fire, storm, shipwreck, or other casualty, or by reason of its theft,

(B) section 38 property is placed in service by the taxpayer to replace the property described in subparagraph (A), and

(C) the reduction in basis or cost of such section 38 property described in the first sentence of section 46(c)(1) is equal to or greater than the reduction in qualified investment which (but for this paragraph) would be made by reason of the substitution required by paragraph (1) with respect to the property described in subparagraph (A).

(b) Section Not to Apply in Certain Cases.—Subsection (a) shall not apply to—

(1) a transfer by reason of death, or

(2) a transaction to which section 381(a) applies.

For purposes of subsection (a), property shall not be treated as ceasing to be section 38 property with respect to the taxpayer by reason of a mere change in the form of conducting the trade or business so long as the property is retained in such trade or business as section 38 property and the taxpayer retains a substantial interest in such trade or business.

(c) Special Rule.—Any increase in tax under subsection (a) shall not be treated as tax imposed by this chapter for purposes of determining the amount of any credit allowable under subpart A.

SEC. 48 (c)(1). USED SECTION 38 PROPERTY.

(1) In general.—For purposes of this subpart, the term "used section 38 property" means section 38 property acquired by purchase after December 31, 1961, which is not new section 38 property. Property shall not be treated as "used section 38 property" if, after its acquisition by the taxpayer, it is used by a person who used such property before such acquisition (or by a person who bears a relationship described in section 179(d)(2)(A) or (B) to a person who used such property before such acquisition).

SEC. 48 (c)(3). DEFINITIONS.

(A) Purchase.—The term "purchase" has the meaning assigned to such term by section 179(d)(2).

(B) Cost.—The cost of used section 38 property does not include so much of the basis of such property as is determined by reference to the adjusted basis of other property held at any time by the person acquiring such property. If property is disposed of (other than by reason of its destruction or damage by fire, storm, shipwreck, or other casualty, or its theft) and used section 38 property similar or related in service or use is acquired as a replacement therefor in a transaction to which the preceding sentence does not apply, the cost of the used section 38 property acquired shall be its basis reduced by the adjusted basis of the property replaced. The cost of used section 38 property shall not be reduced with respect to the adjusted basis of any property disposed of if, by reason of section 47, such disposition involved an increase of tax or a reduction of the unused credit carrybacks or carryovers described in section 46(b).

(C) Affiliated group.—The term "affiliated group" has the meaning assigned to such term by section 1504(a), except that—

(i) the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in section 1504(a), and

(ii) all corporations shall be treated as includible corporations (without any exclusion under section 1504(b)).

SEC. 179 (d)(2). DEFINITIONS AND SPECIAL RULES.

(2) Purchase defined.—For purposes of paragraph (1), the term "purchase" means any acquisition of property, but only if—

(A) the property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b) (but, in applying section 267(b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants),

(B) the property is not acquired by one member of an affiliated group from another member of the same affiliated group, and

(C) the basis of the property in the hands of the person acquiring it is not determined—

(i) in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or

(ii) under section 1014(a) (relating to property acquired from a decedent).

SEC. 453. INSTALLMENT METHOD.

(a) Dealers in Personal Property.—

(1) In general.—Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

(2) Total contract price.—For purposes of paragraph (1), the total contract price of all sales of personal property on the installment plan includes the amount of carrying charges or interest which is determined with respect to such sales and is added on the books of account of the seller to the established cash selling price of such property. This paragraph shall not apply with respect to sales of personal property under a revolving credit type plan or with respect to sales or other dispositions of property the income from which is, under subsection (b), returned on the basis and in the manner prescribed in paragraph (1).

(b) Sales of Realty and Casual Sales of Personalty.—

(1) General rule.—Income from—

(A) a sale or other disposition of real property, or

(B) a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year) for a price exceeding $1,000,

may (under regulations prescribed by the Secretary or his delegate) be returned on the basis and in the manner prescribed in subsection (a).

SEC. 1038. CERTAIN REACQUISITIONS OF REAL PROPERTY.

(a) General Rule.—If—

(1) a sale of real property gives rise to indebtedness to the seller which is secured by the real property sold, and

(2) the seller of such property reacquires such property in partial or full satisfaction of such indebtedness,

then, except as provided in subsections (b) and (d), no gain or loss shall result to the seller from such reacquisition, and no debt shall become worthless or partially worthless as a result of such reacquisition.

Treasury Regulations on Income Tax (1954 Code):

Sec. 1.47-1. RECOMPUTATION OF CREDIT ALLOWED BY SECTION 38.

(a) General rule—(1) In general. (i) If during the taxable year any section 38 property the basis (or cost) of which was taken into account, under paragraph (a) of § 1.46-3, in computing the taxpayer's qualified investment is disposed of, or otherwise ceases to be section 38 property or becomes public utility property (as defined in paragraph (g) of § 1.46-3) with respect to the taxpayer, before the close of the estimated useful life (as determined under subparagraph (2)(i) of this paragraph) which was taken into account in computing such qualified investment, then the credit earned for the credit year (as defined in subdivision (ii)(*a*) of this subparagraph) shall be recomputed under the principles of paragraph (a) of § 1.46-1 and paragraph (a) of § 1.46-3 substituting, in lieu of the estimated useful life of the property that was taken into account originally in computing qualified investment, the actual useful life of the property as determined under subparagraph (2)(ii) of this paragraph. There shall also be recomputed under the principles of §§ 1.46-1 and 1.46-2 the credit allowed for the credit year and for any other taxable year affected by reason of the reduction in credit earned for the credit year, giving effect to such reduction in the computation of carryovers or carrybacks of unused credit. If the recomputation described in the preceding sentence results in the aggregate in a decrease (taking into account any recomputations under this paragraph in respect of prior recapture years, as defined in subdivision (ii)(*b*) of this subparagraph) in the credits allowed for the credit year and for any other taxable year affected by the reduction in credit earned for the credit year, then the income tax for the recapture year shall be increased by the amount of such decrease in credits allowed. For treatment of such increase in tax, see paragraph (b) of this section. For rules relating to "disposition" and "cessation", see § 1.47-2. For rules relating to certain exceptions to the application of this section, see § 1.47-3. For special rules in the case of an electing small business corporation (as defined in section 1371(b)), an estate or trust, or a partnership, see respectively, § 1.47-4, 1.47-5, or 1.47-6.

(ii) For purposes of this section and §§ 1.47-2 through 1.47-6—

(*a*) The term "credit year" means the taxable year in which section 38 pr[illegible]rty was taken into account in computing a taxpayer's qualified inv[illegible]nt.

(*[illegible]* The term "recapture year" means the taxable year in which sect[illegible] property the basis (or cost) of which was taken into account in [illegible]ating a taxpayer's qualified investment is disposed of, or ot[illegible] ceases to be section 38 property or becomes public utility pro[illegible] with respect to the taxpayer, before the close of the estimated usef[illegible] which was taken into account in computing such qualified inves[illegible]

(*c*) [illegible] term "recapture determination" means a recomputation made [illegible]his paragraph.

Sec. 1.47-2. "DISPOSITION" AND "CESSATION".

(b) Leased property—**(1)** In general. For purposes of paragraph (a) of § 1.47–1, generally the mere leasing of section 38 property by a lessor who took the basis of such property into account in computing his qualified investment for the credit year shall not be considered to be a disposition. However, in a case where a lease is treated as a sale for income tax purposes such transaction is considered to be a disposition. Leased section 38 property ceases to be section 38 property with respect to the lessor if, in any taxable year subsequent to the credit year, such property would not qualify as section 38 property (as defined in § 1.48–1) in the hands of the lessor, the lessee, or any sublessee. Thus, if, in a taxable year subsequent to the credit year, a lessee uses the property predominantly outside the United States, such property shall be considered to have ceased to be section 38 property with respect to the lessor.

(2) Where lessor elects to treat lessee as purchaser. For purposes of paragraph (a) of § 1.47–1, if, under § 1.48–4, the lessor of new section 38 property made a valid election to treat the lessee as having purchased such property for purposes of the credit allowed by section 38, the following rules apply in determining whether such property is disposed of, or otherwise ceases to be section 38 property with respect to the lessee:

(i) Generally, a mere disposition by the lessor of property subject to a lease shall not be considered to be a disposition by the lessee.

(ii) If the lessor makes a disposition of property subject to a lease to a person who may not, under § 1.48–4, make a valid election to treat the lessee as having purchased such property for purposes of the credit allowed by section 38 (such as a person described in paragraph (a)(5) of § 1.48–4), such property shall be considered to have ceased to be section 38 property with respect to the lessee on the date of such disposition.

(iii) If a lease is terminated and the property is transferred by the lessee to the lessor or to any other person, such transfer shall be considered to be a disposition by the lessee.

(iv) If the lessee actually purchases such property in the credit year or in a taxable year subsequent to the credit year, such purchase shall not be considered to be a disposition.

(v) The property ceases to be section 38 property with respect to the lessee if in any taxable year subsequent to the credit year such property would not qualify as section 38 property (as defined in § 1.48–1) in the hands of the lessor, the lessee, or any sublessee. Thus, for example, if, in a taxable year subsequent to the credit year, a sublessee uses the property predominantly outside the United States, the property ceases to be section 38 property with respect to the lessee.

Sec. 1.47-3. EXCEPTIONS TO THE APPLICATION OF § 1.47-1.

(g) Sale-and-leaseback transactions. Notwithstanding the provisions of § 1.47–2, relating to "disposition" and "cessation", paragraph (a) of § 1.47–1 shall not apply where section 38 property is disposed of and as part of the same transaction is leased back to the vendor even though gain or loss is recognized to the vendor-lessee and the property ceases to be subject to depreciation in his hands. If paragraph (a) of § 1.47–1 applies with respect to such property subsequent to the transaction, the actual useful life shall begin with the date on which such property was first placed in service by the vendor-lessee as owner.